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OUTSOURCING AND PRIVATIZATION: AN ESSENTIAL  
USAF STRATEGY

by

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## *Preface*

Outsourcing and privatization are much more than buzz words in the USAF today. Together, they represent a fundamental change the service must embrace in order to provide a significant share of the procurement funds needed to meet the challenges of tomorrow. I selected this topic because of its tremendous significance and because of the fundamental changes it will bestow on the support force. As a career "loggie", I am fully appreciative of the dramatic impact outsourcing and privatization will undoubtedly have upon the entire USAF and particularly upon the logistics world because it represents such a large slice of the Air Force manpower pie. Undertakings of this sort are not possible without the help of others and I'd like to take the time to thank those folks who I found indispensable.

First, I would like to thank Col Hogan, my AWC faculty advisor. His insights and assistance were most helpful. His first-hand experience with outsourcing and privatizing Newark AFB provided keen insights into making this paper pass the common-sense test from a "been-there done-that" perspective. Also, I would like to thank Lt Col Donna H. Parry, Deputy Chief Outsourcing and Privatization Division, Directorate of Manpower Organization and Quality, at the Pentagon. She always made time in what has to be an unbelievably busy schedule to keep me up-to-date on the direction the USAF is going concerning outsourcing and privatization.

### *Abstract*

Outsourcing and privatization conversions represent an essential ingredient in shaping the United States Air Force's contribution in meeting the Nation's security needs of the future. Performed properly, outsourcing and privatization will reduce the support "tail" of the Air Force, at a substantially reduced cost, without negatively impacting the "teeth." The reason outsourcing and privatization is so important---money! A conscientious decision to fund operations and maintenance accounts to maintain readiness in light of a very high operations tempo has left some budget areas neglected. Procurement is one of those areas that has suffered especially hard in the most recent years. Our primary weapon systems such as the F-15C and even the F-16, continue to age and are in need of replacement as they near the end of their expected life cycles and as newer technologies make them comparatively less capable. The realities of long-lead time acquisitions necessitate wise procurement investments today to ensure a viable force to meet potential future threats. Therefore, unless the USAF invests in procurement now it stands to lose its global competitive weapons advantage.

This paper will outline the motivation for outsourcing and privatization, describe the process for making it happen, and then outline some of the challenges facing the USAF today along with suggestions for process improvement. Outsourcing and privatization are really not new in the Air Force. In fact, they have been an integral part of the USAF since its inception. However, the current emphasis and projected scope are new.

Outsourcing and privatization offer major dollar savings that can go directly towards solving the existing procurement shortfall, while helping to balance the problematic tooth-to-tail ratio. Research methods used to complete this project included periodicals, studies by RAND and the Defense Science Board, Congressional testimony, and interviews at both the Air Staff and Major Command levels with key personnel involved in formulating and implementing the Air Force outsourcing and implementation strategy.

## **Chapter 1**

### **Why Outsource and Privatize?**

*The hardest things to change are institutions that have been successful and need to change anyway.*

—John White, Deputy Secretary of Defense

#### **Introduction**

Americans have historically demanded their peace dividend subsequent to the conclusion of every war. Although not won on the battlefield, the free world victory in the Cold War has resulted in a demand in the United States for defense savings comparable to that experienced at the conclusion of other conflicts. No longer is the United States faced with national survival as was the case in 40 plus years of a nuclear stand-off with the Soviet Union but, in many ways, the world is more complex today than during the years of the Cold War. The bipolar world created during the Cold War has transformed into a world where regional interests dominate. Today terrorism, the threat of nuclear, biological, and chemical weapons proliferation, along with renewed rivalries between nation states, including ethnic and religious groups, dominate the international scene. These realities have in many ways created a world far more unstable today than during the days of the Cold War.



As America seeks to reap the benefits of winning the Cold War, the nation is faced with tough decisions regarding how much defense is needed in the "new" world. To date, force structure has been rapidly reduced throughout the services with personnel exiting the ranks in huge numbers and weapon system inventories have been drastically slashed. "DoD's force structure today is roughly 30 percent smaller than it was in the 1980's. Our budget has also declined to about 60 percent (in real terms) of its peak in 1985."<sup>1</sup> These cuts have been felt throughout the services and have created imbalances that must be corrected. Among the imbalances is the disproportionate growth in the "tooth-to-tail" ratio since the end of the Cold War. The tooth-to-tail issue is considered such a major concern that Defense Secretary William Cohen established a commission chartered with the responsibility of finding ways to correct the problem. In this regard, the Tooth-to-Tail Commission is charged with finding "...ways to save money in the defense 'tail' portion of the budget...while shifting those savings to the 'tooth'—warfighting segment. That ratio, nearly a 50-50 balance at the end of the Cold War, has moved so that nearly 70 percent of the defense budget now goes toward support elements, said commission members."<sup>2</sup> The challenge is to more efficiently support the warfighter particularly in light of a greatly reduced fiscal environment.

The realities of a greatly reduced budget demands a radically different approach on the part of the support force. Change, although inevitable due to budget considerations, will not be easy to achieve because of the many years of experience with largely organic capabilities and the successes the USAF enjoyed with this approach. From the huge depot repair capabilities to base level, organic support has been the primary means in accomplishing the USAF mission. It has not always been this way however. In fact,

today's support "...activities were largely established and organized during the Cold War when DoD had to depend predominately on organic support. Such support was driven by the possibility of an extended conflict with a rival superpower and a less sophisticated private, commercial infrastructure."<sup>3</sup> Future wars are expected to be regional in nature with the US military tasked to fight two simultaneous major regional conflicts. "These conflicts are often described as 'come as you are' wars, meaning that there will be little lead time for mobilization or surge of production capability."<sup>4</sup> In addition, today's US military plans for a highly mobile battle field made possible due to the advanced weapon systems available in the force today. We expect high technology weapons combined with rapid mobility will bring to bear overwhelming firepower on the enemy, creating a dramatic shock effect and producing what will hopefully be short duration wars. Today's realities demand innovative solutions within the USAF to ensure no diminished support to the warfighter.

Outsourcing and privatization have been adopted by the USAF as an essential cornerstone in providing support to the warfighter in the future. Interestingly, outsourcing and privatization are really not new concepts at all. Due to the huge military buildup during the Cold War the US military turned more and more to organic support to satisfy its needs. Prior to World War II, the US military routinely relied upon the private sector for much of its support. Former Secretary of the Air Force Widnall recently commented, "Lest you think this is a new phenomenon, let me take you back to the era before World War II when private support was standard. It was only during the Cold War when we realized the huge buildup of government operations that we came to think of government support as the norm. In a sense, we're going 'back to the future.'"<sup>5</sup> This

paper argues that the USAF must pursue outsourcing and privatization and use the savings for modernization or it may not be able to meet the national security needs in the future. However, the Air Force must be careful in how it goes about making outsourcing and privatization a reality or it may undermine its ability to perform its wartime mission. Therefore, a well thought-out and deliberate strategy is crucial to success.

Outsourcing and privatization are complex issues and to convert from in-house to a contractor workforce takes time and is a tedious process. Rules and regulations abound, making the process difficult to understand and perhaps a primary reason contractor support of government workload is not more pervasive than it is today. To take full advantage of the benefits outsourcing and privatization offer, there needs to be relief from many of the restrictions currently in place. Furthermore, turning workload over to contractors needs to be supported at all levels throughout the USAF. Transitioning to an outside contractor may seem like a bitter pill to swallow, especially since the in-place organic workforce has traditionally provided quality and responsive support to the needs of the warfighter. However, the existing fiscal demands offer few alternatives. To understand the need, it is first important to understand the terminology to establish common understanding.

### **Outsourcing and Privatization-Key Terms Defined**

Outsourcing and privatization are sometimes referred to as synonymous terms but it is important to understand that they are fundamentally different. In both cases, services are provided to the USAF by contract but in the case of privatization, the contractor has much more autonomy. "Outsourcing refers to the transfer of a support function traditionally performed by an in-house organization to an outside provider.

...While...the government organization continues to provide appropriate oversight, the vendor is typically granted extensive flexibility regarding how the work is performed.”<sup>6</sup> Privatization, in contrast, takes the contracting process even further in that the government divests itself of assets associated with the contracted activity. “Privatization actions involve not only the contracting out of support functions, but also the transfer of facilities, equipment, and other government assets to private vendors.”<sup>7</sup> It is important to note that not all areas are subject to consideration for outsourcing and privatization.

Only those functions that are considered commercial activities are eligible to be performed by contract. “A commercial activity is the process resulting in a product or service that is or could be obtained from a private source.”<sup>8</sup> Just because a particular function fits the commercial activities definition does not automatically make it a contracting candidate. There are several allowable reasons to exempt an otherwise commercial activity from being performed by contract and conversely, allowable conditions to convert a government function to one contractor operated. Appendix 1, extracted from the Office of Management and Budget Circular A-76, provides a detailed explanation of all the conditions. One of the primary reasons the government is allowed to perform an otherwise commercial activity is because the function is considered a core capability. Core capability is defined as:

...a commercial activity operated by a cadre of highly skilled employees, in a specialized technical or scientific development area, to ensure that a minimum capability is maintained. The core capability does not include the skills, functions or FTE (Full Time Equivalents) that may be retained in-house for reasons of National Defense, including military mobilization, security or rotational necessity, or to patient care or research and development activities...<sup>9</sup>

There are some areas that are not considered commercial activities and are totally exempt from cost comparisons since they are considered organic functions of the federal government.

The term 'inherently governmental activity' is applied to those areas in which performance by a commercial contractor does not serve the interests of the nation due to the nature of the work itself. It is "...an activity that is so intimately related to the public interest as to mandate performance by Federal employees."<sup>10</sup> Typically, they are those type of functions which require government employees to perform because of the government's stewardship responsibility of the taxpayers' dollars. A contracting officer or a government auditor are typical examples of areas which are considered inherently governmental.

### **Outsourcing and Privatization Produces Large Savings**

One of the primary reasons the USAF finds outsourcing and privatization so appealing is they offer potentially huge cost savings. The defense department's experience with outsourcing seems to confirm the savings are substantial when comparing organic to contract support. "Cost comparisons conducted between 1978 and 1994 show savings of about \$1.5 billion a year. The military departments and defense agencies that took advantage of outsourcing via competition have reduced their annual operating costs by about 31 percent."<sup>11</sup> Similarly, within the USAF alone, outsourcing has saved an estimated \$500 million a year according to Colonel Michael A. Collins, former Chief of the Air Force outsourcing office.<sup>12</sup> Based on current experience and then applying the cost savings to areas within DoD that offer outsourcing and privatization potential, the savings are potentially enormous. The Defense Science Board Task Force

on Outsourcing and Privatization estimates "...savings of up to \$7 to \$12 billion annually by fiscal year 2002...."<sup>13</sup> It is important to note that both actual and projected savings are suspect according to the General Accounting Office (GAO). In testimony to Congress, the GAO noted that it has been unable to substantiate the savings claimed by the defense department for a variety of reasons. Among the reasons is generally poor cost capturing procedures within DoD and a noticeable trend in cost growth in established contracts.<sup>14</sup> Unlike private industry, DoD is not in the profit making business so managing costs has historically not been a strong suit for the defense establishment. As it tries to capture costs associated with a particular activity, its limited cost managing experience makes the effort difficult and the results suspect. Similarly, DoD's experience in writing service contracts has frequently resulted in contract modifications to the original contract, which routinely cost the government more money because they typically add more workload to the contract. The substantial cost savings claimed by the defense department with outsourcing as noted earlier come exclusively from comparisons with the initial contract and not later when cost growth occurred.<sup>15</sup> According to the USAF outsourcing and privatization office, the GAO has recently been tasked to review existing contracts to determine actual cost growth experienced.<sup>16</sup> In spite of the GAO claims of inconclusive cost savings, the available evidence as highlighted by the Defense Science Board and according to the office of primary responsibility for outsourcing and privatization at Headquarters United States Air Force, the savings are substantial. The dilemma is simply how much are the savings? Arguably, the savings are somewhere between the savings experienced in the private sector where outsourcing applies and the amount claimed by the government.

Outsourcing and privatization are pervasive throughout private industry. Together, they are viewed as a primary way of conducting business and are important ingredients for long-term corporate success. One estimate indicates that the private sector on average saves between 10 and 15 percent in costs due to outsourcing, significantly less than the 31 percent savings expected by the public sector due to the inherent inefficiencies within government.<sup>17</sup> The actual savings for DoD are probably somewhere between the amount claimed by the government and the private sector experience. Therefore, the savings the defense department can reasonably expect is in the billions. Savings of this magnitude can be used to satisfy shortages in other areas, most noticeable procurement.

One of the major areas most severely impacted during the current defense drawdown has been procurement. Funding for procurement has fallen well below the levels needed to replace older weapon systems and to ensure the US maintains its technological advantage in the future. "Over the next five years, the military will have to nearly double its spending on weapons, pouring \$67 billion a year into new planes, ships and other weapons to replace those that are wearing out and to maintain technological superiority on the battlefield..."<sup>18</sup> In reviewing the procurement numbers, it is alarming how much has been reduced in recent years. "In terms of 1996 dollars, procurement has fallen from a peak of \$126 billion in 1985, to just \$39 billion in 1996—a reduction of 69 percent."<sup>19</sup> As discussed earlier in describing the tooth-to-tail dilemma, support functions have actually increased in terms of budget percentage. Recognizing the potential huge savings outsourcing and privatization offer and conversely, the critical need for procurement money, the Air Force has already made plans to redirect savings accordingly. For example, the Air Force has already reprogrammed \$1.2 billion from the base operating

support account into modernization in the Fiscal Year 1998 Programmed Objective Memorandum (POM).<sup>20</sup> However, outsourcing and privatization do not happen overnight so there is much work to be done to make the initial conversions planned in the FY 98 POM. To understand the process, it is important to review some of the major steps necessary to make it a reality.

### Notes

<sup>1</sup> "Improving the Combat Edge Through Outsourcing," *Defense News*, Vol 11, No 30, p. 1.

<sup>2</sup> Weibel, Jack, "Cohen Exhorts Privatization Panel," *Air Force Times*, October 27, 1997, p. 4.

<sup>3</sup> "Improving the Combat Edge Through Outsourcing," *Defense News*, Vol 11, No 30, p. 1.

<sup>4</sup> *Ibid*, p. 1.

<sup>5</sup> Widnall, Sheila E., Secretary of the United States Air Force, "Privatization---A Challenge of the Future," Remarks at the Base and Civic Leader Dinner, McClellan Air Force Base, California, February 7, 1996.

<sup>6</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 6a.

<sup>7</sup> *Ibid*, p. 6a.

<sup>8</sup> Office of Management and Budget, *Circular A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, March 1996.

<sup>9</sup> *Ibid*, p. 35.

<sup>10</sup> *Ibid*, p. 36.

<sup>11</sup> United States Department of Defense, Office of the Undersecretary of Defense for Public Affairs, News Release No. 185-96, Washington, D.C., April 4, 1996.

<sup>12</sup> Arrana-Barradas, Louis A., MSgt, USAF, "Self Interest Drives Outsourcing Boom," *Air Force News Service*, October 2, 1997.

<sup>13</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 1A.

<sup>14</sup> Stevens, L. Nye, Director, Planning and Reporting General Accounting Division, US General Accounting Office, Testimony before United States Congress House Committee on Government Reform and Oversight (104<sup>th</sup> Congress, First Session), "Contracting Out: Summary and Overview," Washington, D.C., March 29, 1995.

<sup>15</sup> General Accounting Office Report (NSIAD-97-86), "Base Operations: Challenges Confronting DoD as It Renews Emphasis on Outsourcing," March 11, 1997.



### Notes

<sup>16</sup> Parry, Donna H., Lt Col, USAF, Deputy Chief Outsourcing and Privatization Division, Directorate of Manpower, Organization, and Quality, Headquarters United States Air Force, interviewed by author, November 13, 1997.

<sup>17</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, DSB, p. 14.

<sup>18</sup> Matthews, William, "Owens: Privatize Bases," *Air Force Times*, October 23, 1995, p. 6.

<sup>19</sup> Gorusch, John F., Industry Benefits from Military Outsourcing," *Industry Trends*, June 1997, p. 36.

<sup>20</sup> Parry, Donna H., Lt Col, USAF, Deputy Chief Outsourcing and Privatization Division, Directorate of Manpower, Organization, and Quality, Headquarters United States Air Force, interviewed by author, November 13, 1997.

## **Chapter 2**

### **The Outsourcing and Privatization Process**

As discussed in Chapter One, the Office of Management and Budget (OMB) Circular A-76, Performance of Commercial Activities, is the cornerstone document for guidance on how to outsource and, as such, is fundamental to the cost comparison between government and contract support. The A-76, appropriate Federal and DoD acquisition regulations, and laws, provide the basis for undertaking the outsourcing decision. The first step is to identify the potential candidates for outsourcing. Then, the government must prepare what is known as the performance work statement (PWS). The PWS provides the foundation of the entire contracting process. Without a good PWS the effort is destined to fail from the beginning because the government will undoubtedly end up with a contract requiring many modifications, resulting in extensive cost growth to the contract. "The PWS defines what is being requested, the performance standards and measures, and timeframes required. It provides the technical performance standards and measures, and timeframes required. It provides the technical performance section of the Request for Proposals (RFP) or Invitation for Bid (IFB) issued by the contracting officer."<sup>1</sup> In other words, the PWS defines what work is to be done, the timelines for its completion, and the standards expected. It is important to note that the PWS should

provide flexibility to the performing activity on how to get the job done. This flexibility and a properly written contract will normally result in the contractor identifying and employing improved efficiencies to get the work accomplished. Naturally, there has to also be a tool for determining how well the contractor meets the requirements.

The Quality Assurance Surveillance Plan (QASP) is the government's oversight plan for the contract to determine contractor performance. This plan "...describes the methods of inspection to be used, the reports required and the resources to be employed with estimated work-hours."<sup>2</sup> It is essential that careful thought be given to this plan in order to provide an unbiased assessment of how well the contractor performs. The QASP provides the report card on how well the contractor performs the contracted workload and provides the basis from which payment incentives associated with the contract are made.

Since the essence of the A-76 process is to compare the most effective method to perform the identified activity between organic government support and contracted support, the government must also prepare a bid for the work. This government effort is known as the management plan.

The Management Plan describes the Government's Most Efficient Organization (MEO) and is the basis of the Government's in-house cost estimate. The Management Plan, which must reflect the scope of the Performance Work Statement, should identify the organizational structures, staffing and operating procedures, equipment, transition and inspection plans necessary to ensure that the in-house activity is performed in an efficient and cost effective manner.<sup>3</sup>

The management plan provides the government with a cost basis for performance of the work and is essential to the competition process.

The solicitation process is used to offer the opportunity for the private sector to bid for the work in competition with the government, with the PWS providing the basis for

the work to be performed. Federal Acquisition Regulations (FAR) provide explicit guidance on the solicitation process. For example, FAR Part 7 requires confidentiality of the government cost estimate until the most cost effective method has been determined.<sup>4</sup> Solicitations must provide open and fair competition, resulting in the overall best value for the government. Once the solicitations have been received the appointed source selection authority makes the final determination regarding whether to accept the in-house government bid or a bid from the private sector. There is also an appeals process to satisfy any complaints from prospective bidders that must also be addressed. As the USAF prepares itself to employ far more use of outsourcing and privatization, it is useful to review the private sector experience in order to gain additional understanding and potential tips on how to make the process successful. The following chapter covers some of these experiences within private industry.

#### Notes

<sup>1</sup> Office of Management and Budget, *Circular A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, March 1996, p. 10.

<sup>2</sup> Ibid, p. 11.

<sup>3</sup> Ibid, p. 11.

<sup>4</sup> Federal Acquisition Regulation Part 7, Acquisition Planning, General Services Administration, Department of Defense, and the National Aeronautics and Space Administration, Washington, D.C., GPO, June 1977, p. 7-7.

## **Chapter 3**

### **Outsourcing and Privatization—the Private Sector Experience**

As mentioned previously, outsourcing and privatization is pervasive throughout private industry. Together, they are viewed as a primary way of doing business and are important ingredients for long-term corporate success. The competitive forces in the United States economy drive businesses to look for the most cost effective means of delivering the most competitive product to the consumers. Although not new to the private sector, recent years have amply demonstrated that there truly is a business revolution underway with outsourcing and privatization serving as cornerstones to the tremendous changes taking place.

The scope of outsourcing within the private sector is tremendous. For example, one estimate expected private industry spending of \$100 billion on outsourcing in 1996 with savings estimated between 10 to 15 percent.<sup>1</sup> There are a variety of ways the private sector cost savings are derived. According to the Defense Science Board findings, the savings can generally be described as coming from five main areas: 1) a lower cost and more flexible work force, 2) more efficient business practices enabling a staff reduction, 3) more efficient utilization of facilities and equipment, 4) cost avoidance in infrastructure, and 5) smaller inventories.<sup>2</sup> Clearly the private sector is saving an enormous amount of money through outsourcing and privatization. These savings help

make them more competitive in the market. However, there are a number of other reasons, in addition to monetary savings, that motivate the private sector to outsource.

Outsourcing allows corporations to focus on their core competencies. Private enterprises tend to focus their energies on those areas they consider fundamental to their organization in order to capitalize on their competitive advantages. Functions necessary for conducting business but not necessarily considered a core competency are prime candidates for outsourcing. It is also important to note that no business, no matter how large or diverse, is able to organically provide all the resources it needs to render final product delivery.<sup>3</sup> Specialization is key to success. By specializing, the company's focus is on fewer areas and therefore is able to identify and capitalize on opportunities. "Specialization, whether of labor or capital, facilitates optimal use of inherent or acquired traits, saves time by focusing on a limited number of tasks, encourages job mastery, and spurs on innovation."<sup>4</sup> Large, diversified organizations on the other hand simply can not respond to the market demand as well as less diversified ones.<sup>5</sup>

Among other private sector benefits derived from outsourcing is overall improved service to the customer. This improved service is evident in a variety of ways such as the overall quality of the service provided, the responsiveness to the need, and the agility of the service provided.<sup>6</sup> It is important to consider that what is not considered a core competency for the large organization is, or at least should be, the core competency of the company seeking to obtain the contract work. By finding those companies whose core competencies satisfy the outsourcing requirement, there is a resultant benefit derived for the outsourcing company.

Outsourcing also enables companies to gain access to technologies they would not otherwise have readily available.<sup>7</sup> This benefit is closely related to the core competency advantage. Generally, it is just not possible for large, complex organizations to take immediate advantage of technological advances, especially in non-core areas. A good example is the computer industry. A company which relies on computer support for the conduct of its business, but is not in the computer hardware or software business itself, may find it especially beneficial to outsource their computer support needs.

Outsourcing is also used to generate funds for the organization. By divesting itself of a particular non-core function, the company can sell the corresponding associated assets.<sup>8</sup> Obviously, if there is no need to provide the support organically, then there is no need to retain the assets previously required to do the work. Depending upon the function in question this can amount to a large sum of money.

The above discussion highlights significant incentives the private sector benefits from when it outsources support. Once the decision is made to outsource, the vehicle to make it happen is the contracting process itself.

### **Establishing and Managing the Contract**

Establishing a contract within the private sector is fairly straight forward in comparison to the government. As a result, the private sector takes significantly less time, on average, to establish a contract than it takes the government. In fact, "outsourcing timelines in the private sector average about 15 months---less than half the DoD average."<sup>9</sup> The reasons for this disparity are many but all relate to the extensive bureaucratic process within the federal government. Simply stated, there are far less restrictions in the private sector arena for the establishment of contracts than within the

government. Not only does it take far less time to establish contracts in private industry, but the private sector generally takes a significantly different view of contracting in general.

It is apparent that the market forces are at work within the private sector when reviewing their approach to contracts. The bottom line in the private sector is profitability, so the motivation is different than in the government. The following describes the approach private enterprise takes to outsourcing:

1. Commercial firms increasingly raise their standards for qualified suppliers, limiting access for suppliers. These firms then deepen their relationships with the suppliers that remain, further limiting the ability of other suppliers to offer them services.
2. Commercial firms experience fraud and abuse in their outsourcing activities. But increasingly, they are learning to accept such problems when they cost more to eliminate than to live with.
3. Commercial firms increasingly emphasize performance over cost, giving increasing attention to subtleties of performance that may be difficult to justify objectively. They are finding that such an approach ultimately yields higher cost-effectiveness, even if they end up paying more for the products they buy.<sup>10</sup>

Commercial firms constantly search for improved ways to deliver their products, and in the case of outsourcing, use competition among suppliers to eliminate those not as strong as others. Some fraud and abuse is expected and is considered the cost of doing business. It does not necessarily mean the firm looks away when fraud is uncovered. It only means that the up-front controls to ensure it does not happen may cost more than the fraud itself. Finally, private industry is now more frequently structuring their contracts to stress results, or performance, than was done in the past. A good example of this performance oriented approach can be observed in the aircraft industry.



The private sector experience with outsourcing and privatization within the aircraft support industry offers a particularly good benchmark for the Air Force since many of the functions are similar. Within the aircraft industry, outsourcing and privatization are common place. In fact, 15 to 20 percent of all the required maintenance is outsourced and this figure is expected to grow.<sup>11</sup> Interestingly, there is a noticeably different approach to outsourcing when comparing the older, more established companies with the younger ones within the industry. "Major airlines can be divided into two groups: younger airlines that have emerged after the late 1970s (the era of airline deregulation), which outsource virtually all of their depot-level maintenance, and the older, established airlines that maintain most of this workload in-house. All major carriers maintain an internal line ("O-level") maintenance capability."

<sup>12</sup> The reason for the different approach is straight forward and primarily dependent on the infrastructure capabilities the older airlines have developed over the years and the difficulties in divesting themselves of it. Also, labor unions and corporate culture are important as well in the outsourcing decision. The established "...airlines have created an extensive maintenance infrastructure and have strong economic incentives to fully utilize these facilities. Union agreements often prohibit outsourcing of work that can be performed by company employees. In many airlines, the corporate culture also plays a role in discouraging full-scale outsourcing."<sup>13</sup> Perhaps even more interesting in studying the private sector airline experience is with the contract itself.

The private sector typically looks for a long-term relationship with a contractor. This provides not only stability but also produces a partnership type approach to the business. In the case of poor performance however, the airlines are able to cancel their

contracts. Five to ten year fixed-price contracts are the norm with the rates negotiated annually.<sup>14</sup> Also, airlines have found a means to more directly tie compensation to performance based upon the reliability of components the contractor provides. Although this approach, known as power-by-the-hour, does not necessarily "fit" all aspects of airline aircraft maintenance, it does offer substantial advantages in some areas and its use is becoming more common.

Power-by-the-hour (PBTH) arrangements are growing in popularity. Under this approach, the airline contracts for performance, rather than a specific repair, and the vendor assumes material management responsibility for the item. PBTH provides airlines with greater maintenance cost stability and predictability, reduces inventories, and gives vendors strong incentives to improve reliability. PBTH arrangements are most prominent in engines, auxiliary power units, landing gear, and tires.<sup>15</sup>

Clearly the private sector has embraced outsourcing and privatization on a broad scale and has benefited substantially from its reliance upon it. Without outsourcing and privatization, industry simply would not be able to remain competitive in providing goods to the market. The government can learn from the private sector experience as it attempts to take advantage of the benefits outsourcing provides. Having established a framework of comparison between the public and private sector, it is now relevant to review where the Air Force is today regarding outsourcing and privatization and make recommendations for the future.

### Notes

<sup>1</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p.14.

<sup>2</sup> Ibid, p. 17.

<sup>3</sup> Prager, Jonas, "Contracting Out Government Services: Lessons from the Private Sector," *Public Administration Review*, Vol 54, No. 2, March/April 1994, p. 176.

<sup>4</sup> Ibid, p. 177.

## Notes

<sup>5</sup> Ibid, p.177.

<sup>6</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 17.

<sup>7</sup> Ibid, p.17.

<sup>8</sup> Ibid, p. 17.

<sup>9</sup> Ibid, p. 21.

<sup>10</sup> Camm, Frank, "Expanding Private Production of Defense Services," The RAND Corporation: Prepared for the Commission on Roles and Missions of the Armed Forces, 1996, p. 7.

<sup>11</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 20.

<sup>12</sup> Ibid, p. 20.

<sup>13</sup> Ibid, p. 20.

<sup>14</sup> Ibid, p. 20.

<sup>15</sup> Ibid, p. 20.

## **Chapter 4**

### **Challenges for the USAF**

There are many challenges the USAF must overcome as it attempts to embrace outsourcing and privatization on a much broader scale. First among these is the need to streamline the outsourcing and privatization process. It simply takes far too long to make outsourcing and privatization a reality. Furthermore, the more complex the function under review, the longer it generally takes to perform the assessment. “The Military Services and Defense agencies report the A-76 process requires 24 months for actions involving relatively simple, narrow functions—and up to 48 months for more broader (syn) or complex support services.”<sup>1</sup> This compares to the guidance in the A-76 Circular of 18 months to complete a single activity or 36 months for a multiple activity function. Studies exceeding these established timelines require justification as to why the delays occurred and must be submitted to the Office of Management and Budget.<sup>2</sup> Extensive legal considerations also significantly contribute to making the outsourcing process unwieldy. A macro review of these laws seem to undermine the Services’ abilities to outsource or at least place formidable roadblocks making it difficult to accomplish. The following table highlights the restrictions and provides a summary of the key issues involved:

Citation	Summary	Citation	Summary
10 USC 2461	Mandates extensive reporting to Congress, including cost comparison study, prior to outsourcing	10 USC 2469	Depot maintenance work >\$3 M may not be outsourced without public/private cost comparison
10 USC 2464	Logistics requirements defined as "core" cannot be outsourced	Sec 8020, FY96 Appro Act	Requires MEO analysis of all functions of >10 DoD civilian employees before outsourcing
10 USC 2465	Prohibits outsourcing of civilian firefighting or security guard functions at military bases	Sec 8043, FY 96 Appro Act	No funds for A-76 studies which exceed 24 months for 1 function or 48 months for >1 function
10 USC 2466	Limits outsourcing of depot maintenance to 40% of total	Sec 317, FY87 Auth Act	Prohibits contracting out of any function at McAlester or Crane Army Ammunition Plants

**Note:** Extracted from the Report of the Defense Science Board Task Force. Report on Outsourcing and Privatization, August 1996, p. 38.

The 40% limitation on outsourcing depot work in Title 10 of US Code 2466, commonly referred to as the 60/40 rule, has most recently been amended to 50%.<sup>3</sup> Collectively, these statutory provisions restrict the flexibility of the services in making outsourcing decisions. It certainly can be argued that most, if not all, of the provisions have been put in place by Congress to ensure some degree of protection for their constituents. However, in light of the current emphasis to implement improved business practices within government especially in light of a greatly reduced fiscal environment, they hinder the Services' abilities to most efficiently meet their needs.

The statutes...increase the involvement of Congress in outsourcing decisions and expand opportunities for Congressional micromanagement; require extensive Congressional notifications and reporting, including the preparation of exhaustive cost analysis studies; impose arbitrary limits on the share of depot-level maintenance workload that may be outsourced to private contractors; and establish arbitrary exemptions from outsourcing of selected functions such as fire safety and physical security. Moreover, the history of Congressional reaction to past DoD outsourcing initiatives has a "chilling effect" on DoD activities that are considering contracting out other workloads. Taken together, the current legal environment encourages the politicization of the outsourcing decision process, and thereby complicates, delays, and discourages DoD efforts to increase its reliance on private vendors for support services.<sup>4</sup>

Although statutory relief is certainly needed in many areas, there are several DoD in-house issues that must also be addressed.

Supporting outsourcing and privatization will be difficult for the USAF. It conflicts with the well-established cultural grain. Outsourcing and privatization are a marked departure from the traditional way of doing business. Considering that defense employees are generally conservative and not prone to risk taking, contracting out workload will be difficult to accept.<sup>5</sup> Changes of this magnitude are not at all unusual no matter what the institution. "Large, successful organizations typically institutionalize and thereby preserve the successful values and procedures that define the status quo. DoD is no exception. Where organic supply exists, DoD organizations will resist any large change, no matter how desirable."<sup>6</sup> Even more important is the concern that contractors will not be there to provide the needed support during periods of wartime operations.<sup>7</sup> No doubt readiness and wartime support are valid concerns and this is precisely why the concept of core functions is important. This is an area in which the USAF is working to address. The USAF does not plan to outsource areas that:

...affect essential military skills or functions that are inherently governmental. Essential military skills are those that:

- Directly contribute to combat or combat support.
- Must be filled by military members by law, such as firefighters and security guards.
- Are military by custom or tradition, such as bands or honor guards.
- Are needed to support overseas rotations.<sup>8</sup>

The USAF approach makes sense and provides a reasonable framework for the outsourcing and privatization process. However, the USAF should work to have arbitrary laws eliminated such as the restrictions prohibiting the outsourcing of firefighters and security guards. In addition, there needs to be a clear delineation concerning what areas directly contribute to combat or combat support. On the surface, this may seem relatively straight forward but in reality will be difficult to define. For example, the fighter pilot flying combat sorties directly contributes to combat but what about the in-theater aircraft maintainers, transporters, and supply personnel? It is precisely this area regarding support personnel where defining which areas directly contribute to combat support becomes somewhat fuzzy. A reasonable approach is to retain organic support for all those areas required for mobility. However, there will still remain a need for contractor support in the theater of operations.

During contingencies and even during the open hostilities of wartime, contractor support has traditionally been essential for many key aspects of the US military. For example, contractors were employed extensively in the theater of operations during DESERT STORM and provide key base support operations today for Operation DECISIVE ENDEAVOR. Contract support during times of contingency is common for the US military. The military just needs to carefully define the criteria for those areas where contract support is both feasible and practical. Once established, the military then

needs to work with the contractors during peacetime to ensure uninterrupted support during actual contingencies.<sup>9</sup>

Required cultural changes also are needed in how DoD deals with contractors to ensure overall maximum efficiency in workload accomplishment. Too often there is a general lack of trust on the part of the government that the contractor will perform as required by the contract. In this regard, "DoD often fosters adversarial relationships with contractors, rather than the needed partnership."<sup>10</sup> One reason is the intrusive oversight the government maintains over contractors because of bad experiences with a relatively small number. The government's answer to fraud has typically been more bureaucratic oversight of the process, penalizing all when only a very small minority of contractors is involved.<sup>11</sup> Arguably, the cost of the bureaucratic process put in place to prevent fraud could more than cover the actual cost of the fraud itself as pointed out earlier when discussing the private sector experience. This is not to say that fraud should be overlooked. However, it should be dealt with swiftly and firmly once uncovered but subsequent actions should only be directed to the guilty party involved rather than levy additional bureaucratic regulatory and legal oversight. As advocated by RAND, "When individual incidents (fraud) occur, the response should not be to revisit the procurement regulations but to punish the perpetrator heavily enough to provide a deterrent for others in the future. That is, enforcement should focus on the isolated wrongdoers when they are caught and not on the activity of contracting as a whole."<sup>12</sup> In addition, the USAF needs to rethink how it structures the contracts themselves.

As mentioned earlier, the PWS frequently focuses on inputs rather than outputs which often leads to a source of friction between the government and the contractor. It is



important to note the PWS should provide the flexibility to the performing activity on how to get the job done. This flexibility and a properly structured contract will normally result in the contractor identifying and employing improved efficiencies to get the work accomplished. Frequently within the USAF however, the functional area experts who develop the PWS's focus on the inputs required to get the work done rather than the results desired. This approach frequently leads to squabbling between the government and the contractor about how the work is being accomplished although, in many cases, the contractor end results meet the requirements of the government.<sup>13</sup> In contrast, performance based contracts offer far greater advantages to both the government and the contractor. By focusing on results rather than how the work is done, the contractor is more able to achieve efficiencies resulting in cost savings for the government while still providing the level of service desired. Certainly there must be restrictions in allowing the contractor to decide how some critical tasks are performed, such as the need to follow technical orders when performing aircraft maintenance, but even in critical areas such as this, there are opportunities to achieve efficiencies.

The USAF also needs to be more creative in how it provides incentives to the contractor. For example, the USAF could make good use of the power-by-the-hour (PBTH) methodology which is being adopted in the aircraft maintenance sector of the private sector. This approach is particularly well suited for current and potential contracts within aircraft maintenance. PBTH does an excellent job in directly tying performance to compensation, which would benefit not only the USAF but the contractor as well.

## **Conclusion**

Outsourcing and privatization offer potentially large savings for the USAF that can be directed to critical procurement needs shortfalls. The USAF must take advantage of this opportunity but it needs to be very careful in how it goes about making outsourcing and privatization a reality. Clearly there will have to be a culture change. Outsourcing and privatization are dramatically different approaches than the organic support the services have largely relied on since World War II. Therefore, it will take sustained top down leadership supporting the initiatives to overcome the tremendous resistance to change. As the USAF embarks on the outsourcing and privatization journey it must not compromise its warfighting ability. In this regard, identifying core functions not available for contract consideration is critically important and is an area which the Air Force has yet to fully address. In addition, Congressional support is also needed for relief from arbitrary outsourcing and privatization restrictions as well as from the excessive reporting and oversight requirements imposed. These restrictions, in large measure, contribute to the extended time required to contract functions within DoD as compared to the private sector. Attention also needs to be paid to the contract itself. The USAF needs to pursue partnership arrangements with contractors focusing more on results than on inputs. In addition, the USAF should pursue power-by-the-hour (PBTH) arrangements for those areas such as aircraft maintenance where it is well suited. The private sector's positive experience with PBTH provides a good example from which the USAF could model. Finally, the USAF should be very careful in how it pursues outsourcing and privatization. There will be a natural tendency to rapidly contract out as much as possible but this approach is dangerous. The Defense Science Board's recommendation is to contract out as much as possible as quickly as possible but this could lead to overall

disaster. In commenting on this point RAND said, "...the Commission implicitly promotes a rapid program of outsourcing that could lead to early failures. That is, if DoD pursues extensive expanded outsourcing without giving such factors adequate attention, it could fail to realize its expectations about performance and reduced costs. Such failures could discredit the notion of expanded outsourcing before such outsourcing has a chance to prove itself."<sup>14</sup> A more measured approach based on a well-conceived strategy will better serve the long-term needs of the Air Force. In conclusion, as stewards of the taxpayers' dollars the USAF has an inherent responsibility to most efficiently provide the forces necessary for national security. Outsourcing and privatization offer significant savings and if approached correctly, will not compromise the Air Force warfighting mission.

#### Notes

<sup>1</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 42a.

<sup>2</sup> Office of Management and Budget, *Circular A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, March 1996, p. 10.

<sup>3</sup> Parry, Donna H., Lt Col, USAF, Deputy Chief Outsourcing and Privatization Division, Directorate of Manpower, Organization, and Quality, Headquarters United States Air Force, interviewed by author, November 13, 1997.

<sup>4</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 38a.

<sup>5</sup> Ibid, p.48.

<sup>6</sup> Camm, Frank, "Expanding Private Production of Defense Services," The RAND Corporation: Prepared for the Commission on Roles and Missions of the Armed Forces, 1996, p. 41.

<sup>7</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 48.

<sup>8</sup> Pulley, John, "A Private Worker May Take Your Job," *Air Force Times*, February 9, 1998, p. 11.

## Notes

<sup>9</sup> Camm, Frank, "Expanding Private Production of Defense Services," The RAND Corporation: Prepared for the Commission on Roles and Missions of the Armed Forces, 1996, p. 21.

<sup>10</sup> United States Department of Defense, Office of the Undersecretary of Defense for Acquisition and Technology, *Report of the Defense Science Board Task Force on Outsourcing and Privatization*, Washington, D.C., April 1996, p. 40.

<sup>11</sup> Camm, Frank, "Expanding Private Production of Defense Services," The RAND Corporation: Prepared for the Commission on Roles and Missions of the Armed Forces, 1996, p. 13.

<sup>12</sup> Ibid, p. 14.

<sup>13</sup> Sampson, Rita G., GS-13, USAF, Contract Advisory Branch Procurement Analyst, Headquarters Air Education and Training Command, interviewed by author, December 3, 1997.

<sup>14</sup> Camm, Frank, "Expanding Private Production of Defense Services," The RAND Corporation: Prepared for the Commission on Roles and Missions of the Armed Forces, 1996, p. 5.

## Appendix

### CONDITIONS PERMITTING GOVERNMENT PERFORMANCE OF COMMERCIAL ACTIVITIES

1. *National Defense or Intelligence Security.* The Secretary of Defense, or designee, approves national defense justifications. The Director of Central Intelligence, or designee, approves national security justifications.
2. *Patient Care.* Commercial activities at Government-owned hospitals or other health facilities may be performed by in-house, ISSA or contract employees when needed to maintain the quality of direct patient care.
3. *Core Capability.* A core capability of in-house and contract resources may be warranted for certain functional areas.
4. *Research and Development.* Research and development activities may be converted to or from in-house, contract or ISSA without cost comparison. Severable support activities are subject to the cost comparison provisions of this Supplement.
5. *No Satisfactory Commercial Source Available.* Agencies will solicit private sector interest and certify that the solicitation did not restrict or otherwise limit competition.
6. *Functions With 10 or Fewer FTE.* May be converted to or from in-house, contract or ISSA, without a cost comparison, if the contracting officer determines that reasonable prices cannot otherwise be obtained.
7. *Meet Performance Standard.* Agencies may demonstrate that the activity meets or exceeds generally recognized industry cost and performance standards, after all adjustments required by this Supplement.
8. *Lower Cost.* Results of a cost comparison demonstrate that in-house performance is less costly.
9. *Temporary Authorization.* Temporary emergency performance may be warranted not to exceed the next full contract option year.

### CONDITIONS PERMITTING CONTRACT PERFORMANCE OF COMMERCIAL ACTIVITIES

1. *Contracted Activities.* Should be obtained by contract, unless a cost comparison demonstrates that in-house or ISSA performance is more cost effective.
2. *New Requirement.* Should be obtained by contract, unless contract quality or price appear unreasonable. A cost comparison is performed to convert the activity to in-house or ISSA performance.

3. *Severable Expansions*. Same as above.
4. *ISSAs*. Commercial activities should not be performed through new or expanded ISSAs, except as provided by law or this supplement.
5. *Activities With 10 or Fewer FTE*. May be converted to or from in-house, contract or ISSA, without a cost comparison.
6. *Activities with 11 or More FTE*. May be converted to contract or ISSA, without cost comparison, if fair and reasonable contract prices can be obtained by competitive award and all directly affected Federal employees on permanent appointments can be reassigned to other Federal positions.
7. *Activities Performed by the Military*. Activities performed by military (uniformed) personnel may be converted to contract without cost comparison. Military positions included in cost comparisons are cost at the composite rates provided by the DOD or other appropriate agency Comptroller.
8. *Preferential Procurement Programs*. Contract performance may be granted, without cost comparison, if the contract is awarded to a preferential procurement program.
9. *Lower Cost*. Conversion to contract is required if a cost comparison indicates that contract performance is the lower cost alternative.

**Note:** Extracted from Office of Management and Budget, *Circular A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, March 1996, p. 7.

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